

CALIFORNIA OFFICE OF ADMINISTRATIVE LAW

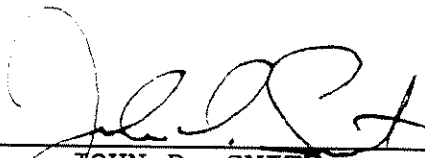
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SACRAMENTO, CALIFORNIA

MARCH FONG EU
SECRETARY OF STATE
OF CALIFORNIA

In re:)	1989 OAL Determination No. 16
Request for Regulatory)	
Determination filed by)	[Docket No. 89-004]
The Fieldstone Company)	
concerning the State)	December ²² 8, 1989
Energy Resources and)	
Development Commission's)	Determination Pursuant to
policy regarding the need)	Government Code Section
for "specific intent" to)	11347.5; Title 1, California
qualify for passive solar)	Code of Regulations, Chapter
energy system tax)	1, Article 2
credits)	

Determination by:


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SYNOPSIS

The issue presented to the Office of Administrative Law is whether or not the Energy Commission's policy requiring taxpayers to prove "specific intent" to qualify for passive solar energy system tax credits, is a "regulation" required to be adopted in compliance with the Administrative Procedure Act.

The Office of Administrative Law has concluded that this policy is a "regulation" required to be adopted in compliance with the Administrative Procedure Act. We note that some elements of the policy were contained in a statute enacted by the Legislature after the Fieldstone request was filed, but before this determination was issued.

THE ISSUE PRESENTED ²

The Office of Administrative Law ("OAL") has been requested³ to determine⁴ whether or not the State Energy Resources Conservation and Development Commission's ("CEC") policy (as reflected in a letter to the Franchise Tax Board ("FTB") concerning the Fieldstone Company) regarding the need for "specific intent to qualify for passive solar energy tax credits, is a "regulation" required to be adopted pursuant to the Administrative Procedure Act.⁵

THE DECISION ^{6, 7, 8, 9, 10}

OAL finds that:

- (1) rules issued by CEC are specifically required by the Public Resources Code to be adopted pursuant to the Administrative Procedure Act ("APA");
- (2) the policy announced by CEC in its letter to FTB concerning the Fieldstone Company is a "regulation" as defined in the key provision of Government Code section 11342, subdivision (b);
- (3) this regulatory policy is not exempt from the requirements of the APA; and, therefore,
- (4) this policy violates Government Code section 11347.5, subdivision (a).

R E A S O N S F O R D E C I S I O N

I. AGENCY; AUTHORITY; BACKGROUND

Agency

The State Energy Resources Conservation and Development Commission ("Commission" or "CEC") was created by Warren-Alquist Act in 1974.¹¹ CEC's responsibilities include, among other things, adopting regulations to encourage the development and use of solar energy.¹²

Authority ¹³

CEC has been granted general rulemaking authority by Public Resources Code section 25213, which states in part:

"The commission shall adopt rules and regulations, as necessary, to carry out the provisions of [Division 15 - "Energy Conservation and Development"] in conformity with the provisions of [the APA]." [Emphasis added.]

Public Resources Code section 25605 grants CEC specific authority to adopt regulations governing solar devices. Section 25605 states in part:

"On or before November 1, 1978, the commission shall develop and adopt, in cooperation with affected industry and consumer representatives, and after one or more public hearings, regulations governing solar devices. The regulations shall be designed to encourage the development and use of solar energy and to provide maximum information to the public concerning solar devices." [Emphasis added.]

It is relevant in this Determination to also note prior statutes that have granted CEC specific rulemaking authority in the area of solar energy tax credits. Former Revenue and Taxation Code sections 17052.5, subdivision (f), and 23601, subdivision (d), each provided in part:¹⁴

"The Energy Resources Conservation and Development Commission shall, after one or more public hearings, establish guidelines and criteria for solar energy systems which shall be eligible for the credit provided by this section. These guidelines and criteria may include, but shall not be limited to, minimum requirements for safety, reliability and durability of solar energy systems. . . ." [Emphasis added.]

Background

To facilitate better understanding of the issues presented in this determination, we set forth the following facts.

As part of California's policy to promote conservation of energy, the Legislature, in 1976, enacted Revenue and Taxation Code sections 17052.5 and 23601 ("solar tax credit statutes"). Prior to their repeal in 1987, sections 17052.5 and 23601 provided for tax credits on a percentage of the cost of installing "solar energy systems" on taxpayers' premises.¹⁵

Responsibility for establishing guidelines and criteria for solar energy systems to be eligible for tax credits was statutorily delegated to CEC by former Revenue and Taxation Code sections 17052.5, subdivision (f), and 23601, subdivision (d). CEC carried out its task by adopting the regulations contained in Title 20, Chapter 2, Subchapter 8, Article 1 ("Solar Tax Credits"), sections 2601 through 2607 of the California Code of Regulations.¹⁶ Although Revenue and Taxation Code sections 17052.5 and 23601 no longer exist, the CEC regulations remain. The regulations govern the determination of eligibility of claims for the years when the solar tax credit statutes were still in effect.¹⁷ FTB apparently relies on CEC to determine whether individual claims qualify for the credit under the applicable statutes and regulations.

According to a comment submitted in this proceeding, in about 1986, the CEC heard a report that a consultant was contacting developers, encouraging them to file amended state income tax returns to claim passive solar tax credits for houses built in earlier years.¹⁸ Several such applications were received and approved. Apparently after receiving even more such applications, CEC concluded that while the structures in question contained "materials [which] have minimum thermal properties required by CEC regulations," the structures had not been intended to nor did they "have any substantial solar heating benefit."¹⁹ The CEC's primary reviewer of solar energy tax credit applications concluded that it was not appropriate to allow tax credits for such components. To do so would permit developers to further exploit a "loophole" to reap "windfall tax credits." According to CEC, undertaking a rulemaking was not a viable option at this point because the statutes authorizing the credit had been repealed. The record does not disclose whether consideration was given to filing an action for declaratory relief or to seeking legislative action.

December 22, 1989

Then, according to commenter Robert C. Fellmeth, attorney for the William Lyon Co. (whose solar tax credit application has also been denied):

"[to] make the tax credit more restrictive, and thus to disqualify more claims, the FTB asked the CEC to formally request of it (the FTB) a 'formal ruling' (ostensibly to fall outside of the 'regulations' definition of Government Code section 11342(b)) on the applicability of an additional requirement--that of specific intent."²⁰

In July 1988, CEC requested a "formal ruling" from FTB regarding the applicability of former Revenue and Taxation Code sections 17052.5 and 23601 to certain solar tax credit claims.²¹ CEC asked the following question:

"Do structural elements which were not designed or intended at the time of installation to apply solar energy for the individual function of collection, storage or distribution of solar energy nevertheless constitute a 'solar energy system' within the meaning of Revenue and Taxation Code 17052.5 and 23601 if they physical characteristics are as described in CEC regulations setting forth criteria for eligible passive thermal systems?" [Emphasis added.]

FTB replied by providing CEC with a copy of a letter issued by the Chief Counsel ("Chief Counsel letter"), dated July 28, 1988, which stated in part:

"CEC Regulations (Cal. Admin. Code Title 20, Ch. 2, Subch. 8, Article 1, [sections] 2601-2607) were promulgated pursuant to Revenue and Taxation Code [section] 23601(d) (17052.5(f)) which provides that the CEC shall establish 'guidelines' and 'criteria' for solar energy systems which shall be eligible for the credit. Specifically, the CEC was to establish minimum requirements for safety, reliability and durability of the systems.

Implicit in this language is that the CEC's regulations were to be restrictive, not permissive. If a taxpayer came up with a 'system' which theoretically would work to conserve energy, but it was not safe, durable and reliable, the credit should be denied. Both the statutes and the regulations themselves ([section] 2601(a)) limit the function of the regulations to specifying which solar energy systems qualify for the credit. Before the specific guidelines and criteria of the regulations are even applicable, there must in fact be a 'solar energy system' as defined by the Revenue and Taxation Code. [Emphasis in original.]

"A 'solar energy system' includes a 'passive thermal system.' A passive thermal system is a system which utilizes the structural elements of the building to provide for collection, storage or distribution of solar energy for heating or cooling. [Emphasis in original.]

"We have reviewed the legislative history of the provisions defining the term 'passive thermal system' and find no indication of legislative intent to allow a credit for the cost of standard structural building elements which were not designed or intended at the time of installation to specifically apply solar energy in the manner indicated.

"Therefore, if it is determined as a factual matter during the review by the CEC that the components in question were not designed or intended at the time of installation to utilize solar energy in the prescribed manner, the items in question do not constitute 'passive thermal systems' or 'solar energy systems' within the meaning of the statutes or regulations. In such cases, the Energy Commission must therefore rule that a 'passive thermal system' is not present."
[Emphasis added.]

FTB's position was apparently adopted by CEC in its evaluation of individual claims for solar tax credits.²² In a letter to FTB, dated September 9, 1988, which rejected Fieldstone's claim, CEC wrote:

"This letter provides a final recommendation regarding passive solar tax credits claimed by the Fieldstone Company for three homes on an amended tax return for 1984. Our recommendation was determined with support from the Franchise Tax Board's Legal Division provided in correspondence dated July 28, 1988.

". . .

"According to the FTB letter referred to previously, the CEC must [!] make a determination of whether the items claims as qualifying for the tax credit were in fact intended at the time of installation to be used as solar devices and to serve the individual functions described in the enabling statute. In order to determine whether passive solar thermal systems were intended at the time of installation for residential subdivision, the following questions would have to be answered affirmatively:

- "1. Has the subdivision and/or homes in the subdivision clearly been planned and designed

December 22, 1989

for passive solar thermal systems? Are passive solar thermal principles of subdivision design followed in the planning of the development?

- "2. Is there a clear, integrated design of solar collection, storage, and control/distribution for the passive solar thermal systems being claimed? Is thermal mass adequately designed with the solar glazing so that the system can yield significant energy savings?
- "3. Is there documenting evidence that the taxpayer had completed solar designs and performance estimates for the system before the installation occurred? Are there reasonable engineering calculations which estimate the performance of the system?"

[Emphasis added.]

On February 14, 1989, the Fieldstone Company ("Requester") submitted a formal Request for Determination to OAL challenging the criteria for determining eligibility for solar tax credits stated in CEC's September 9, 1988 letter to FTB ("the challenged rule"). The Request states in part:

" . . . the Fieldstone Company recently received a copy of a letter from the CEC, in which an additional requirement for qualification was added: a specific intent requirement was deemed necessary in order to take advantage of passive solar energy system tax credits. . . . Further, this additional requirement was imposed post facto and required proof that measurements and studies of the effects of the proposed systems were completed prior to the implementation -- demonstrating a prior intent. . . .

"The Fieldstone Company believes that the CEC has added and employed a specific intent requirement in order to cancel passive solar energy system tax credit qualification and the application of those rules to taxpayers who had qualified under rules that were in effect during tax years 1981 through 1986.

"Query: Where an agency had duly adopted specific rules to qualify for passive solar energy system tax credits [i.e., the solar tax credit regulations contained in sections 2601-2607 of Title 20 of the California Code of Regulations] and where those rules have been relied upon, can the rules be altered or supplemented by declaration of the agency without subsequent rulemaking amending the applicable adopted

rules? I.e., is [CEC's September 9, 1988 letter to FTB an] underground rulemaking which in fact requires compliance with Administrative Procedure Act standards under the jurisdiction of the Office of Administrative Law?"

[Emphasis in original.]

II. ISSUES

Before reaching the dispositive issues in this determination, we first address CEC's contention that its role in determining eligibility of solar tax credits is merely advisory and that all decisions on such eligibility are made by FTB.

We initially note that the responsibility of CEC and FTB with respect to the determination of eligibility for solar tax credits under former Revenue and Taxation Code sections 17052.5 and 23601 is somewhat muddled. Those prior statutes specifically mandated CEC to "establish guidelines and criteria for solar energy systems which shall be eligible for the credit." It logically follows, therefore, that eligibility for solar tax credits be determined by regulations established by CEC. Both FTB and CEC, however, assert that FTB has independent authority to determine eligibility for solar tax credits and that CEC only serves to advise FTB as to the "technical" eligibility of individual claims.²²

The only statutory authority of which we are aware that specifically pertains to FTB's role with respect to the allowance to solar tax credits under former Revenue and Taxation Code sections 17052.5 and subdivision (d) of former section 23601 each stated in part:

"The Energy Resources Conservation and Development Commission shall, after one or more public hearings, establish guidelines and criteria for solar energy systems which shall be eligible for the credit provided by this section. . . . [FTB] shall prescribe such regulations as may be necessary to carry out the purposes of this action."

FTB has not cited, nor are we aware of, any regulation it has adopted to implement, interpret or make specific the solar tax credit statutes.²³ Accordingly, it appears that FTB's and CEC's description of their respective parts in determining eligibility for solar tax credits is without support.

In addition, whether or not an agency action is "regulatory" hinges on the effect and impact on the public--not on the agency's characterization of the action.²⁴ Even though

CEC's evaluation of the eligibility of a particular claim is presented to FTB as a "final recommendation," such a recommendation may be tantamount to a final determination as to whether or not a taxpayer will be awarded the claimed-for solar tax credit. FTB has not indicated in what instances, if any, a final recommendation from CEC would not be followed.²⁵

Finally, even if the enacting agency expressly disavows any regulatory intent (as in this case), analysis of the text of the challenged rule may compel the conclusion that it is regulatory in nature, and that it fits the APA's definition of a "regulation."²⁶ As we have previously pointed out in other Determinations,²⁷ the enforceability of the challenged rule is not also dispositive for purposes of our review.²⁸

We now proceed with our Determination by turning to the three main issues before us:²⁹

- (1) WHETHER THE APA IS APPLICABLE TO CEC'S QUASI-LEGISLATIVE ENACTMENTS.
- (2) WHETHER THE CHALLENGED RULE IS A "REGULATION" WITHIN THE MEANING OF THE KEY PROVISION OF GOVERNMENT CODE SECTION 11342.
- (3) WHETHER THE CHALLENGED RULE FALLS WITHIN ANY ESTABLISHED EXCEPTION TO APA REQUIREMENTS.

FIRST, WE INQUIRE WHETHER THE APA IS APPLICABLE TO CEC'S QUASI-LEGISLATIVE ENACTMENTS.

The APA generally applies to all state agencies, except those in the "judicial or legislative departments."³⁰ Since CEC is in neither the judicial nor legislative branch of state government, we conclude that APA rulemaking requirements generally apply to that agency.³¹

Additionally, Public Resources Code section 25213 provides in part:

"The commission shall adopt rules and regulations, as necessary, to carry out the provisions of [Division 15 - "Energy Conservation and Development"] in conformity with the provisions of [the APA]." [Emphasis added.]

We are aware of no statutory exemption which would permit CEC to conduct rulemaking without compliance with the APA.

SECOND, WE INQUIRE WHETHER THE CHALLENGED RULE IS A "REGULATION" WITHIN THE MEANING OF THE KEY PROVISION OF GOVERNMENT CODE SECTION 11342.

In part, Government Code section 11342, subdivision (b), defines "regulation" as:

" . . . every rule, regulation, order, or standard of general application or the amendment, supplement or revision of any such rule, regulation, order or standard adopted by any state agency to implement, interpret, or make specific the law enforced or administered by it, or to govern its procedure, . . . " [Emphasis added.]

Government Code section 11347.5, authorizing OAL to determine whether or not agency rules are "regulations," provides in part:

"(a) No state agency shall issue, utilize, enforce, or attempt to enforce any guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule, which is a ['']regulation[''] as defined in subdivision (b) of Section 11342, unless the guideline, criterion, bulletin, manual, instruction [or] . . . standard of general application . . . has been adopted as a regulation and filed with the Secretary of State pursuant to [the APA]. . . ." [Emphasis added.]

Applying the definition of "regulation" found in Government Code section 11342, subdivision (b), involves a two-part inquiry:

First, is the challenged rule either

- o a rule or standard of general application or
- o a modification or supplement to such a rule?

Second, has the challenged rule been adopted by the agency to either

- o implement, interpret, or make specific the law enforced or administered by the agency or
- o govern the agency's procedure?

The answer to the first part of the inquiry is "yes." For an agency rule or standard to be "of general application" within the meaning of the APA, it need not apply to all citizens of the state. It is sufficient that the criteria for determining eligibility for solar tax credits stated in CEC's letter apply to all members of a class, kind or order.³² Although the letter specifically refers to the claim of the Requester, its application is certainly not

limited to that specifically named party. Rather, the rules announced in CEC's letter apply to all taxpayers seeking solar tax credits under former Revenue and Taxation Code sections 17052.5 and 23601.³³

The answer to the second party of the inquiry is also "yes." The criteria for eligibility set forth in the challenged procedures.

The language of prior Revenue and Taxation Code sections 17502.5 and 23601 did not specifically require that taxpayers seeking a solar tax credit have a specific intent when installing solar energy systems on their premises. That requirement, however, has been adopted by CEC following issuance of FTB's Chief Counsel letter of July 28, 1988. (As discussed above, CEC has also issued additional, detailed guidelines specifying how such intent may be established.)

As we understand it, CEC argues that it has made no interpretation of law and that any such interpretation was made by FTB.³⁴ Certainly, CEC is not legally bound by FTB's opinion as to the state of the law. By incorporating FTB's interpretation of law into CEC's policy, therefore, CEC has in effect announced its own (albeit influenced) interpretation of law. The critical question before us, therefore, is whether or not the conclusion that intent must be demonstrated constitutes an "interpretation" of law within the meaning of Government Code section 11342, subdivision (b).

FTB claims its Chief Counsel letter "essentially reiterated the language of the statute and applied the plain meaning of the statute to the factual situation presented."³⁵ A review of that letter reveals that the challenged position is based on the fact that there is "no indication of legislative intent to allow credit for the cost standard structural building elements which were not designed or intended at the time of installation to specifically apply solar energy in the manner indicated."³⁶ In our view, the absence of any "indication of legislative intent" is feeble support for the argument the solar credit tax statutes, without so stating, impose an eligibility requirement of an intent to install solar energy systems to utilize solar energy in the manner prescribed.

The issue of whether or not specific intent is required for eligibility for solar tax credits was recently argued in William Lyon Company v. Franchise Tax Board, San Diego County Superior Court, Case No. 606598. By order filed September 5, 1989 (on a Motion for Summary Judgment), the court ruled that:

"In order to qualify for a passive solar tax credit under Revenue and Taxation Code [section] 23601 (1982), it is not necessary that the taxpayer prove intent to qualify for the credit or intent to build a passive solar power system." [Emphasis added.]

Shortly after that ruling, legislation on that same issue was enacted. Section 163 of Chapter 1352 of California Statutes 1989 (AB 802), effective upon filing on October 2, 1989, states:

- "(a) For purposes of former Sections 17052.5 and 23601 of the Revenue and Taxation Code, a 'solar energy system' for which a credit is allowed must be composed of interrelated elements which were designed and intended at the time of installation to perform the individual functions specified in either subparagraph (A) of paragraph (6) of subdivision (h) of former Section 17052.5 or subparagraph (A) of paragraph (6) of subdivision (f) of former Section 23601."
- "(b) A credit shall not be allowed for any structural components which were not designed and intended at the time of installation to constitute a 'solar energy system,' as defined in subdivision (a)."
- "(c) The provisions of this section are declaratory of existing law and do not constitute a change in requirements which must be satisfied in order to claim a credit under the provision of former Section 17052.5 or 23601."³⁷

[Emphasis added.]

We note that Chapter 1352 does not nullify the San Diego Superior Court ruling. It is well recognized that a statement in new legislation to the effect that it does not constitute a change in, but is declaratory of, a preexisting law, is not binding in the courts.³⁸ Regardless of the recent legislation, a court may still find that there was no intent requirement for eligibility for solar tax credits under former Revenue and Taxation Code sections 17052.5 and 23601.^{39, 40}

As pointed out by CEC, it is not OAL's function to decide the correctness of the challenged interpretation of law. Our function is to merely determine if the interpretation under review is the only viable interpretation (i.e., a restatement) of the law. The San Diego Superior Court case of William Lyon Company v. Franchise Tax Board clearly demonstrates that it is not. Thus, we conclude that the challenged intent policy did not merely restate the law, but rather interpreted it.

CEC has also established supplemental rules to implement its primary interpretation of the law. CEC's September 9, 1988 letter to FTB states in part:

"In order to determine whether passive solar thermal systems were intended at the time of installation for residential subdivision, the following questions would have to be answered affirmatively:

- "1. Has the subdivision and/or homes in the subdivision clearly been planned and designed for passive solar thermal systems? Are passive solar principles of subdivision design followed in the planning of the development?
- "2. Is there a clear, integrated design of solar collection, storage, and control/distribution for the passive solar thermal systems being claimed? Is thermal mass adequately designed with the solar glazing so that the system can yield significant energy savings?
- "3. Is there documenting evidence that the taxpayer had completed solar designs and performance estimates for the system before the installation occurred? Are there reasonable engineering calculations which estimate the performance of the system?"

[Emphasis added.]

Even assuming arguendo that the former solar tax credit statutes required that a specific intent exist for eligibility for solar tax credits, the guidelines set forth by CEC for finding such intent nonetheless implement the law.⁴¹ The above-quoted rules not only govern what CEC must review, but also require that there be some documentary evidence showing the taxpayer's intent.

Also, even if CEC's role in determining eligibility was advisory only, the rules set forth for finding the element of intent (i.e., the rules upon which a recommendation to FTB is to be based) nonetheless govern CEC's procedure. It appears undeniable that CEC will follow the same procedure in reviewing the intent requirement for all claims prior to making a recommendation to FTB.⁴²

We conclude, therefore, that the intent policy (including the three supplemental guidelines) is a "regulation" as defined in Government Code section 11342, subdivision (b).⁴³

THIRD, WE INQUIRE WHETHER THE CHALLENGED RULE FALLS WITHIN ANY ESTABLISHED EXCEPTION TO APA REQUIREMENTS.

Does the CEC policy statement fall within the "rulings of tax counsel" exception?

Rules concerning certain activities of state agencies--for instance, "internal management"--are not subject to the procedural requirements of the APA.⁴⁴ One such exception specifically pertains to what will be termed "legal rulings of tax counsel." Government Code section 11342, subdivision (b), states in part:

"'Regulation' does not mean or include legal rulings of counsel issued by the Franchise Tax Board or State Board of Equalization." [Emphasis added.]

Based on this provision, both CEC and FTB argue that (1) not only FTB's July 28, 1988 "ruling," but also (2) CEC's use of a policy allegedly derived from that ruling is exempt from all APA requirements.

Though we have some doubts⁴⁵ on the first point, we need not decide today whether or not FTB's July 1988 "ruling" is itself within the scope of the statutory exception. FTB's use of the ruling has not been challenged in this proceeding. Concerning the second point--whether CEC's use of the intent policy is within the scope of the "rulings of counsel" exception--we must disagree. Though the matter is not wholly free from doubt, we conclude, in light of the totality of circumstances surrounding CEC issuance of the intent requirement, that the "rulings of tax counsel" exception cannot reasonably be stretched to encompass what the CEC did here--supplementing a "properly adopted regulatory provision with a document of lesser stature which is nonetheless intended to have identical legal effect."⁴⁶ We are not persuaded that the Legislature intended the "rulings of tax counsel" exception to serve as a panacea for all regulatory ailments.

Part of the challenged CEC rule can't fall within "rulings" exception

At the outset, it must be pointed out that the challenged CEC rule may be divided into two distinct parts: one part essentially repeats the opinion of FTB with respect to the intent requirement for solar tax credit eligibility. The second part includes specific guidelines for the establishment of such intent. These guidelines are not found in the FTB opinion. Thus, even if the part of the challenged CEC rule which repeats FTB's opinion were deemed to be exempt from the APA under the "legal rulings of tax counsel" exception, the exemption could not be applied to the remainder of the challenged policy.

We conclude that, under the rather unusual and complex circumstances presented here, the challenged CEC policy is not exempt under Government Code section 11342, subdivision (b) in that the CEC policy is not a "ruling of tax counsel."

We reach this conclusion for the following reasons:

1. APA exceptions should be strictly construed to further the statutory goals of meaningful public participation in rulemaking and effective judicial review.
2. Given that the Legislature specifically mandated CEC to follow the APA in adopting regulations governing CEC review of solar tax credit applications, and given the basic principle that significance should be given to every statutory word, phrase and sentence, we must reject the CEC/FTB argument that CEC may utilize portions of FTB rulings of counsel in lieu of complying with the Public Resources Code (or in lieu of seeking to amend the statute).
3. The legislative history of the "rulings of tax counsel" exception contains no indications that the Legislature contemplated use of the taxpayer request procedure by "third-party" state agencies which would then utilize the conclusions of the "ruling" in lieu of duly adopted regulations.

REASON NO. 1--BASIC APA PURPOSES: MEANINGFUL PUBLIC PARTICIPATION AND EFFECTIVE JUDICIAL REVIEW

Let us consider four basic principles of statutory interpretation:

- A. A statute should be construed with a view toward promoting rather than defeating its general purpose and the policy behind it.⁴⁷
- B. In interpreting a statute, it is proper to consider the consequences that will flow from a particular interpretation.⁴⁸
- C. A specific provision should be construed with reference to the entire statutory scheme of which it is a part.⁴⁹
- D. When a statute contains an exception to a general rule laid down therein, that exception is strictly construed.⁵⁰

BASIC PRINCIPLE "A"--APA'S GENERAL PURPOSE AND POLICY

What is the general purpose and policy behind the rulemaking portion of the APA? The basic purposes of the rulemaking portion of the California APA have been summed up by the California Court of Appeal, Third District, as meaningful public participation and effective judicial review.⁵¹ What are the advantages of public participation in agency rulemaking? The following points may be distilled from pertinent appellate court opinions:⁵¹

*Following formal rulemaking procedures gives notice to affected persons of forthcoming controls.

*Affected persons are given an opportunity to be heard; in light of judicial deference and legislative concern with other matters, voicing concerns in the rulemaking process may be an affected person's only practical defense mechanism.

*Public participation can reduce the risk of factual errors, arbitrary actions, and unforeseen detrimental consequences.

*Agencies become more responsive to public concerns, in accord with traditional democratic values.

*Agencies receive pertinent information and helpful advice from public commenters, including

*additional policy considerations

*weaknesses in the proposed regulation

*alternative means of achieving the same objectives.

*Public participation in developing new agency policies can:

*dispel suspicions of agency predisposition, unfairness, improper influences, and ulterior motivation;

*decrease the likelihood that opponents will sabotage the regulation's implementation and enforcement (such as by challenging the new policy in court).

Thus, following the first basic principle of statutory interpretation, we conclude that the APA should be construed with a view toward promoting rather than defeating its general purposes: meaningful public participation, effective judicial review, and accessibility of agency rules.

BASIC PRINCIPLE "B"--CONSEQUENCES OF A PARTICULAR INTERPRETATION

According to the second principle of statutory interpretation cited above, it is also proper to consider the consequences that will flow from a particular interpretation. Here, if we expansively interpret an APA exception, we diminish the extent to which the public can shape administrative enactments; we lessen the extent to

which reviewing courts can have ready access to the documents and facts associated with rulemaking efforts; we limit the extent to which the public can have access to pertinent rules.

Why did the Legislature require state agencies to provide public notice and hearing in connection with rulemaking activities? Basically, the idea was to provide opportunities for public input, akin to those that exist in the legislative arena, before a new rule goes into effect.

Effective judicial review means that the rulemaking process will result in a complete administrative record, permitting the court to perform a thorough and expeditious review of the challenged regulation's validity. The more complete the administrative record, the less likely an opponent of the new regulation would be able to successfully attack it as, for instance, arbitrary and capricious or not reasonably necessary. Policy and legal problems can be worked out in the administrative rulemaking process, often leading to substantial savings in litigation costs to both the rulemaking agency and the regulated public.

Another fundamental benefit of the APA is that rules used by a given agency are codified in one place--the California Code of Regulations. Members of the regulated public are less likely to require high-priced legal assistance in gaining access to the rules that govern their activities. In the not-too-distant future, the entire CCR will be available on-line to public and private sector subscribers, who will then have instant access via computer terminal to regulations of interest. California state agencies will have the option of subscribing through the state-operated Teale Data Center to on-line access to the entire CCR. These agencies will also be able to use a sophisticated research program to locate regulations containing particular words or combinations of words.

BASIC PRINCIPLE "C"--CONSTRUE IN LIGHT OF ENTIRE STATUTORY SCHEME

What guidance may we draw from the next basic principle of statutory interpretation: a specific provision should be construed with reference to the entire statutory scheme of which it is a part.

State agencies issuing rules interpreting statutes or regulations must generally follow rulemaking procedures prescribed in the APA.⁵² Some agencies, such as the State Lottery Commission, have been totally exempted from the APA. When the Legislature wishes to give an agency a total exemption, it knows what to say in the statute. Agencies which have not been wholly exempted have a duty to comply

with the APA in areas not expressly covered by the exemption statute.

BASIC PRINCIPLE "D"--STRICT CONSTRUCTION OF EXEMPTIONS

What guidance may we draw from the principle that when a statute contains an exception to a general rule laid down therein, the exception is strictly construed? Shall we read the "rulings of tax counsel" exception as something akin to a blank check, in which concerned rulemaking agencies have unlimited discretion to forego APA rulemaking procedures? Or, should we view the exception as encompassing some but not all tax-related agency enactments? What led up to the 1983 enactment of the "rulings of tax counsel" exception? The key event seems to have been the passage of AB 1013 in 1982.

AB 1013, the bill which added section 11347.5 to the Government Code, was signed by the Governor in March 1982 and took effect January 1, 1983. AB 1013 was vigorously opposed by a number of state agencies, basically on the grounds that it would compel them to put more of their rules through the APA process. Some agencies sought exemptions from the proposed law from the Legislature. Other agencies sought exemptions from OAL during an OAL rulemaking in 1983. Other agencies obtained exemptions after Government Code section 11347.5 became effective.

Reviewing the legislative history of the "rulings of tax counsel" exception, we note the following. The proposal to exclude "rulings of tax counsel" from the APA process first surfaced in a letter dated March 7, 1983 from Clifton B. Cates, III, Chair of the Taxation Section of the State Bar of California to two other apparent lawyer-members of the Section, with copies to various parties, including Ronald Lofstrom, senior consultant to Assemblyman Bruce Young. The letter states that Assemblyman Young had agreed to "sponsor our proposed amendment of Government Code section 11347.5 to exclude private rulings and similar pronouncements by the Franchise Tax Board and the State Board of Equalization." [Emphasis added.] AB 227 was a bill primarily directed toward establishing new economic impact requirements that proposed regulations would have to meet.

In a second letter dated April 7, 1983, addressed to Senior Consultant Lofstrom, Taxation Section Chair Cates enclosed a draft of proposed language for an amendment to Government Code section 11342. This proposed language was eventually enacted without modification in AB 227 (Statutes of 1983, Chapter 1080). It is noteworthy that the proponents of the "legal rulings of tax counsel" exclusion selected a relatively modest response to the tax agencies' APA compliance problems: unlike other legislation, the bill did not propose to totally exempt either the FTB or the State

December 22, 1989

Board of Equalization (SBE) from APA requirements. Instead, the bill --introduced as a technical amendment--sought merely to exempt one category of tax agency pronouncements from APA rulemaking requirements.

Both the FTB and the SBE supported AB 227, after it was amended to exclude "rulings of tax counsel" from the definition of "regulation." In a memo to Assemblyman Young dated June 6, 1983, FTB Executive Officer Gerald Goldberg noted that the "legal rulings" exclusion "will allow the department to continue a valuable taxpayer service." [Emphasis added.] In a bill analysis dated July 10, 1983, the FTB Assistant Executive Officer stated:

"Legal rulings issued by department counsel have not been subjected to the OAL review process, although the existing definition of 'regulation' can be construed broadly to include rulings."

". . .

"The statutory determination that regulations do not include rulings permits their issuance without the administrative burdens associated with the OAL review process. Because rulings are of significant assistance to taxpayers seeking the department's advice, continuation of this service in the most expedient manner is desirable [; the department] would be able to continue to provide a valuable taxpayer service." [Emphasis added.]

In July 1983, a third state agency (the Department of Justice) requested Assemblyman Young to include its "Attorney General opinions" in the exclusion provided FTB and SBE.⁵³ This request was clearly denied; no change was made.

In a letter dated August 19, 1983, to Alfred E. Alquist, Chairman of the Senate Finance Committee, SBE Executive Secretary Douglas D. Bell supported AB 227's exclusion of "rulings of tax counsel," explaining that "[t]ypically, these rulings are sought by tax advisors or industry representatives as an aid in planning business transactions or advising clients on the application of tax." [Emphasis added.]

These quotations from contemporaneous documents clearly indicate that the legislative concerns in excluding "rulings of tax counsel" from the definition of "regulation" was to permit taxpayers to continue to seek advice from the two tax agencies, especially as an aid in planning business transactions.

REASON NO. 2--GIVING SIGNIFICANCE TO EVERY STATUTORY WORD, PHRASE, AND SENTENCE: MANDATE TO FOLLOW THE APA

The Legislature specifically mandated CEC to follow APA procedures in adopting regulations governing CEC review of energy tax credit applications.⁵⁴ In fact, the Legislature insisted that CEC go beyond minimal APA requirements in two ways: (1) it mandated a public hearing (under the APA a live public hearing need not be held in the absence of a specific request) and (2) it directed CEC to cooperate with "affected industry and consumer representatives" in developing regulations.

It is not to be presumed that the Legislature used language in a sense that would render meaningless important provisions of a statute.⁵⁵ Should we read the "rulings of tax counsel" exception as somehow relieving CEC of its statutory rulemaking duties? According to the California Supreme Court, courts are "extremely reluctant to attach an interpretation to a particular statute which renders other statutes unnecessary."⁵⁶ If possible, significance should be given to every word, phrase, and sentence in furtherance of the legislative purpose.⁵⁷ "A cardinal rule of construction is that . . . a construction making some words surplusage is to be avoided."⁵⁸

Here, not content with applicable Government Code sections which already obligated CEC to follow APA rulemaking procedures, the Legislature took action to (1) pass an additional law specifically re-mandating APA compliance, (2) require CEC consultation with industry and consumers, and (3) impose a mandatory public hearing requirement.

Thus, we cannot accept the argument that CEC may utilize portions of the FTB rulings of counsel in lieu of complying with the Public Resources Code's mandate to follow augmented APA public notice and comment procedures.

REASON NO. 3--LACK OF INTENT THAT THIRD PARTY AGENCIES USE RULINGS IN LIEU OF ADOPTING REGULATIONS

In a 1986 determination involving application of the "rulings of tax counsel" exception, we encountered an extremely broad interpretation of the "rulings of tax counsel" exception, an interpretation that would have effectively exempted virtually 100% of tax-related SBE pronouncements.⁵⁹

In the proceeding at hand, the scope of the "rulings of tax counsel" exception has come before us in quite different factual context. Here, a rulemaking agency which is not mentioned in the exception is nonetheless seeking to use the exception to excuse its admitted failure to comply with its

December 22, 1989

enabling act's express requirement that the agency follow the APA is adopting rules on a particular subject.

(Assuming arguendo that repeal of the specific underlying tax credit statutes wholly terminated CEC's rulemaking authority in this area [a questionable assumption], CEC had the option of legitimating its intent policy by either filing an action for declaratory relief or by seeking legislative action.)

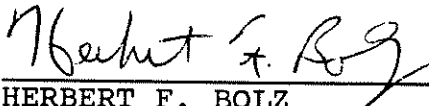
A thorough review of the legislative history of the 'rulings of tax counsel' exception has failed to unearth any indications that the Legislature contemplated use of the optional taxpayer request procedure by third-party agencies in lieu of duly adopted regulations. Such use gives us pause. We are unable to conclude that the pertinent Public Resources Code provisions were impliedly repealed by AB 227.

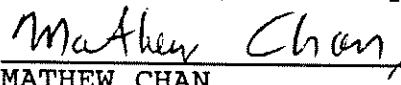
III. CONCLUSION

For the reasons set forth above, OAL finds that:

- (1) rules issued by CEC are specifically required by the Public Resources Code to be adopted pursuant to the Administrative Procedure Act ("APA");
- (2) the policy announced by CEC in its letter to FTB concerning the Fieldstone Company is a "regulation" as defined in Government Code section 11342, subdivision (b);
- (3) the policy is not exempt from the requirements of the APA; and, therefore,
- (4) the policy violates Government Code section 11347.5, subdivision (a).

DATE: December 22, 1989


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1. This Request for Determination was filed by William C. Brucks, Tax Manager for the Fieldstone Company, 14 Corporate Plaza, Newport Beach, CA 92660, (714) 851-8313. The California Energy Commission was represented by Stephen M. Rhoads, Executive Director, 1516 Ninth Street, Sacramento, CA 95814-5512, (916) 324-3308.

To facilitate the indexing and compilation of determinations, OAL began, as of January 1, 1989, assigning consecutive page numbers to all determinations issued within each calendar year, e.g., the first page of this determination is "539" rather than "1."

2. The legal background of the regulatory determination process -- including a survey of governing case law--is discussed at length in note 2 to 1986 OAL Determination No. 1 (Board of Chiropractic Examiners, April 9, 1986, Docket No. 85-001), California Administrative Notice Register 86, No. 16-Z, April 18, 1986, pp. B-14--B-16; typewritten version, notes pp. 1-4.

In August 1989, a second survey of governing case law was published in 1989 OAL Determination No. 13 (Department of Rehabilitation, August 30, 1989, Docket No. 88-019), California Regulatory Notice Register 89, No. 37-Z, p. 2833, note 2. The second survey included (1) five cases decided after April 1986 and (2) seven pre-1986 cases discovered by OAL after April 1986. Persuasive authority was also provided in the form of nine opinions of the California Attorney General which addressed the question of whether certain material was subject to APA rulemaking requirements.

Since August 1989, the following authorities have come to light:

Los Angeles v. Los Olivas Mobile Home P. (1989) -- Cal.App.3d --, 262 Cal.Rptr. 446, 449 - Citing Jones v. Tracy School Dist. (1980) 27 Cal.3d 99, 165 Cal.Rptr. 100 (a case in which an internal memorandum of the Department of Industrial Relations became involved) the Second District Court of Appeal refused to defer to the administrative interpretation of a rent stabilization ordinance by the city agency charged with its enforcement because the interpretation occurred in an internal memorandum rather than in an administrative regulation adopted after notice and hearing.

Readers aware of additional judicial decisions concerning "underground regulations"--published or unpublished--are invited to furnish OAL's Regulatory Determinations Unit with a citation to the opinion and, if unpublished, a copy of the opinion. (Whenever a case is cited in a regulatory determination, the citation is reflected in the Determinations

Index.) Readers are also encouraged to submit citations to Attorney General opinions addressing APA compliance issues.

3. Government Code section 19572 provides:

"Each of the following constitutes cause for discipline of [a state] employee:

". . . .

"Unlawful retaliation against any other state officer or employee or member of the public who in good faith reports, discloses, divulges, or otherwise brings to the attention of, the Attorney General, or any other appropriate authority, any facts or information relative to actual or suspected violation of the law of this state or the United States occurring on the job or directly related thereto." [Emphasis added.]

4. Title 1, California Code of Regulations ("CCR") (formerly known as California Administrative Code), section 121, subsection (a) provides:

"'Determination' means a finding by [OAL] as to whether a state agency rule is a regulation, as defined in Government Code section 11342, subdivision (b), which is invalid and unenforceable unless it has been adopted as a regulation and filed with the Secretary of State in accordance with the [APA] or unless it has been exempted by statute from the requirements of the [APA]." [Emphasis added.]

See Planned Parenthood Affiliates of California v. Swoap (1985) 173 Cal.App.3d 1187, 1195, n. 11, 219 Cal.Rptr. 664, 673, n. 11 (citing Gov. Code sec. 11347.5 in support of finding that uncodified agency rule which constituted a "regulation" under Gov. Code. sec. 11342, subd. (b), yet had not been adopted pursuant to the APA, was "invalid").

5. Government Code section 11347.5 provides:

"(a) No state agency shall issue, utilize, enforce, or attempt to enforce any guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule, which is a [']regulation['] as defined in subdivision (b) of Section 11342, unless the guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule has been adopted as a regulation and filed with the Secretary of State pursuant to this chapter.

"(b) If the office is notified of, or on its own, learns of the issuance, enforcement of, or use of, an agency guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule which has not been adopted as a regulation and filed with the Secretary of State pursuant to this chapter, the office may issue a determination as to whether the guideline, order, standard of general application, or other rule, is a ['']regulation[''] as defined in subdivision (b) of Section 11342.

"(c) The office shall do all of the following:

1. File its determination upon issuance with the Secretary of State.
2. Make its determination known to the agency, the Governor, and the Legislature.
3. Publish a summary of its determination in the California Regulatory Notice Register within 15 days of the date of issuance.
4. Make its determination available to the public and the courts.

"(d) Any interested person may obtain judicial review of a given determination by filing a written petition requesting that the determination of the office be modified or set aside. A petition shall be filed with the court within 30 days of the date the determination is published.

"(e) A determination issued by the office pursuant to this section shall not be considered by a court, or by an administrative agency in an adjudicatory proceeding if all of the following occurs:

1. The court of administrative agency proceeding involves the party that sought the determination from the office.
2. The proceeding began prior to the party's request for the office's determination.
3. At issue in the proceeding is the question of whether the guideline, criterion, bulletin, manual, instruction, order,

standard of general application, or other rule which is the legal basis for the adjudicatory action is a [']regulation['] as defined in subdivision (b) of Section 11342." [Emphasis added.]

6. As we have indicated elsewhere, an OAL determination pursuant to Government Code section 11347.5 is entitled to great weight in both judicial and adjudicatory administrative proceedings. See 1986 OAL Determination No. 3 (Board of Equalization, May 28, 1986, Docket No. 85-004) California Administrative Notice Register 86, No. 24-Z, June 13, 1986, p. B-22; typewritten version, pp. 7-8; Culligan Water Conditioning of Bellflower, Inc. v. State Board of Equalization (1976) 17 Cal.3d 86, 94, 130 Cal.Rptr. 321, 324-325 (interpretation of statute by agency charged with its enforcement is entitled to great weight). The Legislature's special concern that OAL determinations be given appropriate weight in other proceedings is evidenced by the directive contained in Government Code section 11347.5, subdivision (c): "The office shall . . . [m]ake its determination available to . . . the courts." (Emphasis added.)

7. Note Concerning Comments and Responses

In general, in order to obtain full presentation of contrasting viewpoints, we encourage not only affected rulemaking agencies but also all interested parties to submit written comments on pending requests for regulatory determination. (See Title 1, CCR, sections 124 and 125.) The comment submitted by the affected agency is referred to as the "Response." If the affected agency concludes that part or all of the challenged rule is in fact an "underground regulation," it would be helpful, if circumstances permit, for the agency to concede that point and to permit OAL to devote its resources to analysis of truly contested issues.

Public comments were timely submitted by attorney Robert C. Fellmeth (Alcala Park, San Diego, CA 92110, (619) 260-4806) on behalf of the William Lyon Company in support of the Request for Determination (letter dated September 7, 1989) and by FTB (letter dated September 8, 1989) in support of CEC. CEC's Response to the Request for Determination was received by OAL on September 20, 1989.

All of the above-noted documents were considered in rendering this determination.

8. If an uncodified agency rule is found to violate Government Code section 11347.5, subdivision (a), the rule in question may be validated by formal adoption "as a regulation"

(Government Code section 11347.5, subd. (b)) or by incorporation in a statutory or constitutional provision. See also California Coastal Commission v. Quanta Investment Corporation (1980) 113 Cal.App.3d 579, 170 Cal.Rptr. 263 (appellate court authoritatively construed statute, validating challenged agency interpretation of statute).

9. Pursuant to Title 1, CCR, section 127, this Determination shall become effective on the 30th day after filing with the Secretary of State. This Determination was filed with the Secretary of State on the date shown on the first page of this Determination.
10. We refer to the portion of the APA which concerns rulemaking by state agencies: Chapter 3.5 of Part 1 ("Office of Administrative Law") of Division 3 of Title 2 of the Government Code, sections 11340 through 11356.

The rulemaking portion of the APA and all OAL Title 1 regulations are both reprinted and indexed in the annual APA/OAL regulations booklet, which is available from OAL's Information Services Unit for \$3.00.

11. Public Resources Code sections 25000-25986.
12. Public Resources Code section 25605.
13. We discuss the affected agency's rulemaking authority (see Gov. Code, sec. 11349, subd. (b)) in the context of reviewing a Request for Determination for the purposes of exploring the context of the dispute and of attempting to ascertain whether or not the agency's rulemaking statute expressly requires APA compliance. If the affected agency should later elect to submit for OAL review a regulation proposed for inclusion in the California Code of Regulations, OAL will, pursuant to Government Code section 11349.1, subdivision (a), review the proposed regulation in light of the APA's procedural and substantive requirements.

The APA requires all proposed regulations to meet the six substantive standards of Necessity, Authority, Clarity, Consistency, Reference, and Nonduplication. OAL does not review alleged "underground regulations" to determine whether or not they meet the six substantive standards applicable to regulations proposed for formal adoption.

The question of whether the challenged rule would pass muster under the six substantive standards need not be decided until such a regulatory filing is submitted to us under Government

Code section 11349.1, subdivision (a). At that time, the filing will be carefully reviewed to ensure that it fully complies with all applicable legal requirements.

Comments from the public are very helpful to us in our review of proposed regulations. We encourage any person who detects any sort of legal deficiency in a proposed regulation to file comments with the rulemaking agency during the 45-day public comment period. (Only persons who have formally requested notice of proposed regulatory actions from a specific rulemaking agency will be mailed copies of that specific agency's rulemaking notices.) Such public comments may lead the rulemaking agency to modify the proposed regulation.

If the review of a duly-filed public comment leads us to conclude that a regulation submitted to OAL does not in fact satisfy an APA requirement, OAL will disapprove the regulation. (Gov. Code, sec. 11349.1.)

14. Sections 17052.5 and 23601 were repealed by their own terms. (Stats. 1986, ch. 1200, secs. 1, 2, p. 4252, eff. Sept. 26, 1986, operative Jan. 1, 1987.) All references to these sections shall be to the version amended by California Statutes, 1986, chapter 1200.
15. Former section 17052.5 allowed a credit against the amount of "net tax" under Division 2, Part 10 ("California Personal Income Tax Law") of the Revenue and Taxation Code. Former section 23601 allowed a credit against the taxes imposed by Division 2, Part 11 ("Bank and Corporation Tax Law") of the Revenue and Taxation Code.
16. Regulation section 2601 states in part:
 - "(a) Purpose. The purpose of this article is to establish guidelines and criteria which specify solar energy systems and energy conservation measures applied in conjunction with solar energy systems which are eligible for state tax credits pursuant to Sections 17052.5, 17208, 23601 and 24349 of the Revenue and Taxation Code.
 - (b) Application and Scope. There shall be allowed as a credit against the taxes imposed by Parts 10 and 11 of Division 2 of the Revenue and Taxation Code.
 - (c) Eligibility. No solar energy system shall be eligible for tax credit provided by this section, unless such solar energy system satisfies the minimum requirements established in these regulations. Costs eligible for the credit shall include those costs

actually incurred by the taxpayer for design or engineering of the solar system, installation, materials, and the costs of acquiring the recording solar easements."

17. When all such claims have been settled, the CEC regulations should be repealed. (Stats. 1989, ch. 1170, sec. 1, adding Government Code section 11349.10, eff. Jan. 1, 1990.)
18. Opposition of FTB to Motion of Lyon for Summary Judgment, p. 5, in Lyon v. FTB, part of comment submitted by Robert C. Fellmeth, dated September 7, 1989.
19. Id., p. 6.
20. F. pleading, p. ____.
21. It has been suggested that FTB make a request for a "formal ruling" on the specific intent requirement issue so that FTB could avoid the rulemaking requirements of the APA. (William Lyon Company v. Franchise Tax Board, San Diego Superior Court, Case no. 606598, Memorandum of Points and Authorities in Support of Motion for Summary Judgment, p. 12.)
22. Compare CEC's September 9, 1988 letter to FTB concerning solar tax credits claimed by the Fieldstone Company ("Requester") with CEC's December 28, 1988 letter to FTB concerning credits claimed by The William Lyon Company.

In FTB's September 9, 1988 letter to OAL, FTB points out that:

"Virtually identical factual situations are currently being considered as appeals from denial of claim for refund and of proposed assessments of additional tax by the State Board of Equalization in the Appeal of Weyerhaeuser Company, filed 12/13/88, Case No. B89-0111 and the Appeal of William Lyon Company, filed 5/24/89, Case No. B89-0707; and by the Superior Court of San Diego County in William Lyon Co. v. Franchise Tax Board, SD No. 587801."

22. It is CEC's responsibility to make factual determinations on individual claims. (See Response, p. 3.)

23. Our review of Title 18 of the California Code of Regulations reveals that no such regulation exists.
24. Winzler & Kelly v. Department of Industrial Relations (1981) 121 Cal.App.3d 120, 128, 174 Cal.Rptr. 744.
25. Based on the language of the prior solar energy tax credit statutes, it appears that once eligibility is established, FTB would have no discretion to deny the solar tax credit. Both former Revenue and Taxation Code sections 17052.5 and 23601 began with the words, "There shall be allowed as a credit. . . ."
26. 1986 OAL Determination No. 6 (Bay Conservation and Development Commission, September 3, 1986, Docket No. 86-002, CANR 86, No. 38-Z, September 19, 1986, p. B-18.
27. Id.
28. Government Code section 11347.5, subdivision (a), states:

"No state agency shall issue, utilize . . . any guideline . . . standard of general applicability, or other rule, which is a regulation. . . ." [Emphasis added.]
29. See Faulkner v. California Toll Bridge Authority (1953) 40 Cal.2d 317, 324 (point 1); Winzler & Kelly v. Department of Industrial Relations (1981) 121 Cal.App.3d 120, 174 Cal.Rptr. 744 (points 1 and 2); and cases cited in note 2 of 1986 OAL Determination No. 1. A complete reference to this earlier Determination may be found in note 2 to today's Determination.
30. Government Code section 11342, subdivision (a). See Government Code sections 11343, 11346 and 11347.5. See also Auto and Trailer Parks, 27 Ops.Cal.Atty.Gen. 56, 59 (1956). For a complete discussion of the rationale for the "APA applies to all agencies" principle, see 1989 OAL Determination No. 4 (San Francisco Regional Water Quality Control Board and the State Water Resources Control Board, March 29, 1989, Docket No. 88-006), California Regulatory Notice Register 89, No. 16-Z, April 21, 1989, pp. 1026, 1051-1062; typewritten version, pp. 117-128.
31. See Winzler & Kelly v. Department of Industrial Relations (1981) 121 Cal.App.3d 120, 126-128, 174 Cal.Rptr. 744, 746-747 (unless "expressly" or "specifically" exempted, all state

agencies not in legislative or judicial branch must comply with rulemaking part of APA when engaged in quasi-legislative activities); Poschman v. Dumke (1973) 31 Cal.App.3d 932, 943, 107 Cal.Rptr. 596, 603.

32. Roth v. Department of Veterans Affairs (1980) 110 Cal.App.3d 622, 167 Cal.Rptr. 552.
33. See note 18.
34. On page three of CEC's Response, CEC refers to FTB's ruling as "Chief Counsel Rigby's statutory interpretation."
35. See FTB's September 8, 1989 letter to OAL, p. 3.
36. FTB's Chief Counsel letter, dated July 28, 1988, p. 4. The same language appears in CEC's letters to FTB concerning claims filed by the Requester and by the William Lyon Company.
37. Section 163 was added to AB 802 by amendment in July 12, 1989, after the San Diego Superior Court case of William Lyon Company v. Franchise Tax Board was already in progress.
38. See, Gibbons & Reed Co. v. Dept. of Motor Vehicles (1963) 220 Cal.App.2d 277, 287, 33 Cal.Rptr. 688, 694 (overruled on other grounds); California Emp. Etc. Com. v. Payne (1947) 31 Cal.2d 210, 213-214; County of Sacramento v. State (1982) 134 Cal.App.3d 428, 434, 184 Cal.Rptr. 648, 651, n. 5.
39. The California Supreme Court case of California Emp. Etc. Com. v. Payne (1947) 31 Cal.2d 210, well illustrates this point. In that case, the Court reviewed the effect of an amendment to section 45.2 of the Unemployment Insurance Act and the corresponding declaratory statement that "the amendment . . . to section 45.2 . . . is hereby declared to be merely a clarification of the original intention of the legislature rather than a substantive change and such section shall be construed for all purposes as though it had always read as hereinbefore set forth." On pages 213-214 of its decision, the Court wrote:

"The construction of statutes is a function of the judiciary, but where a statute is ambiguous various aids may be employed in determining the legislative intent, and a subsequent expression of the Legislature as to the intent of the prior statute, although not binding on the

court, may be used in determining the effect of a prior act. [Citations.] In the instant case, however, section 45.2 was not ambiguous as to the matter of intent to evade the act. Under the section as enacted in 1939, the running of the statute of limitations against the state was suspended, if no return was filed, whether or not the employer had an intent to evade the act. The amendment to section 45.2 in 1943 added the further condition that an intent to evade the act be shown before the running of the statute of limitations should be suspended, and the declaration of the Legislature that the amendment in 1943 was merely a clarification of the original statute, may not be invoked to change the clear meaning of section 45.2 as first enacted . . . [T]he language of the 'clarification' provision in this case cannot be given an obviously absurd effect, and the court cannot accept the Legislative statement that an unmistakable change in the statute is nothing more than a clarification and restatement of its original terms."

40. It is curious that the Legislature felt it necessary to make a declaration that prior law required "specific intent" for eligibility for solar tax credits if such a requirement was so obvious from a reading of former Revenue and Taxation Code sections 17052.5 and 23601.
41. FTB's September 8, 1989 letter to OAL refers to "the California Energy Commission's implementation of the Franchise Tax Board ruling."
42. We note that although the factors established for determining the absence or presence of the element of intent are to be considered by CEC staff, those rules do not only affect CEC staff. Obviously, they have significant impact on the claimants for solar tax credits. Consequently, such rules do not fall into an "internal management" exception to the APA. (See Government Code section 11342, subdivision (b).)
43. CEC argues that the adoption of a "regulation" under APA procedures was not possible in this instance as Revenue and Taxation Code sections 17052.4 and 23601 have been repealed. CEC contends, therefore, that it no longer can cite to the required "authority" and "reference" statutes under Government Code section 11349.

We remind CEC that prior Revenue and Taxation Code sections 17052.5 and 23601 were not the only sections cited by it as "authority" in sections 2601 through 2607 of Title 20 of the California Code of Regulations. Those regulations also cite to existing Revenue and Taxation Code sections 25213 and 25605

as "authority." Section 25213 grants to CEC broad authority to adopt regulations in the area of "Energy Conservation and Development." It appears therefore that section 25213 may be cited for both "authority" and "reference." Statutes 1986, chapter 1200, sections 1 and 2, p. 4252 (last amended version of prior sections 17052.5 and 23601) may also be cited in the "reference" note for historical purposes.

As explained in note 12, we need not resolve the issue of the adequacy of "authority" and "reference" citations at this time.

44. The following provisions of law may permit rulemaking agencies to avoid the APA's requirements under some circumstances:
- a. Rules relating only to the internal management of the state agency. (Gov. Code, sec. 11342, subd. (b).)
 - b. Forms prescribed by a state agency or any instructions relating to the use of the form, except where a regulation is required to implement the law under which the form is issued. (Gov. Code, sec. 11342, subd. (b).)
 - c. Rules that "[establish] or [fix] rates, prices, or tariffs." (Gov. Code, sec. 11343, subd. (a)(1).)
 - d. Rules directed to a specifically named person or group of persons and which do not apply generally throughout the state. (Gov. Code, sec. 11343, subd. (a)(3).)
 - e. Legal rulings of counsel issued by the Franchise Tax Board or the State Board of Equalization. (Gov. Code, sect. 11342, subd. (b).)
 - f. There is limited authority for the proposition that contractual provisions previously agreed to by the complaining party may be exempt from the APA. City of San Joaquin v. State Board of Equalization (1970) 9 Cal.App.3d 365, 376, 88 Cal.Rptr. 12, 20 (sales tax allocation method was part of a contract which plaintiff had signed without protest); see Roth v. Department of Veterans Affairs (1980) 110 Cal.App.3d 622, 167 Cal.Rptr. 552 (dictum); Nadler v. California Veterans Board (1984) 152 Cal.App.3d 707, 719, 199 Cal.Rptr. 546, 553 (same); but see Government Code section 11346 (no provision for non-statutory exceptions to APA requirements); see International Association of Fire Fighters v. City of San Leandro (1986) 181 Cal.App.3d 179, 182, 226 Cal.Rptr. 238, 240 (contracting party not estopped from challenging legality of "void and unenforceable" contract provision to which party had previously agreed); see Perdue v. Crocker National Bank (1985) 38 Cal.3d 913, 926, 216 Cal.Rptr. 345, 353 ("contract of adhesion" will be denied

December 22, 1989

enforcement if deemed unduly oppressive or unconscionable).

The above is not intended as an exhaustive list of possible APA exceptions. Further information concerning general APA exceptions is contained in a number of previously issued OAL determinations. The quarterly Index of OAL Regulatory Determinations is a helpful guide for locating such information. (See "Administrative Procedure Act" entry, "Exceptions to APA requirements" subheading.)

The Determinations Index, as well as an order form for purchasing copies of individual determinations, is available from OAL (Attn: Tande' Montez), 555 Capitol Mall, Suite 1290, Sacramento, CA 95814, (916) 323-6225, ATSS 8-473-6225. The price of the latest version of the Index is available upon request. Also, regulatory determinations are published every two weeks in the California Regulatory Notice Register, which is available from OAL at an annual subscription rate of \$108.

Through the quarterly Determinations Index is not published in the Notice Register, OAL accepts standing orders for Index updates. If a standing order is submitted, OAL will periodically mail out Index updates with an invoice.

45. As noted by FTB, we have had occasion to review the applicability of the legal rulings exception. In 1986 OAL Determination No. 3, (1986 OAL Determination No. 3 (Board of Equalization, May 28, 1986, Docket No. 85-004), CANR 86, No. 24-Z, June 13, 1986. p. B-10) it was argued that a "County Assessors Letter" was exempt from the requirements of the APA as it constituted a "legal ruling of counsel" issued by the Board of Equalization. There, we concluded that (1) the "County Assessors Letter" was not a "legal ruling of counsel" because it lacked certain characteristics and (2) "[I]f . . . the Board realizes that a new rule of statewide application is necessary in order to properly interpret or implement a tax statute, the Board . . . should nonetheless begin a rulemaking action by preparing a notice of proposed rulemaking." [Emphasis added.]

In its September 8, 1989 letter to OAL, FTB explains that:

"Franchise Tax Board's legal ruling of counsel dated July 28, 1988, [was] issued in response to the Executive Director of the California Energy Commission . . . [and that such] ruling referenced a published ruling by Franchise Tax Board Chief Counsel also dated July 28, 1988: Solar Energy Credits, at Time of Installation."

December 22, 1989

Examination of the attachments submitted with FTB's letter discloses a short letter, dated July 28, 1988, to the Executive Director of CEC and a letter dated July 28, 1988, identified as 410:BLR:CR-88-357, "Re Solar Energy Credits, Structural Elements Not Designed or intended to Apply Solar Energy at Time of Installation."

The only significant portion of FTB's letter to CEC reads:

"Enclosed please find a copy of a letter sent to the tax services addressing the subject of your ruling request of July 13, 1988."

It is manifest that such a letter does not constitute a "legal ruling of counsel." FTB simply provided CEC with a copy of a letter, issued under the name of its Chief Counsel, which responded to CEC's concerns. By doing so, FTB was clearly advising CEC as to the basis for making recommendations to FTB.

This Chief Counsel letter, however, was not directed to any specific person and did not answer specific legal questions concerning the solar tax credit eligibility of a particular taxpayer in a particular situation. Instead, the letter articulated a rule of general application for all taxpayers in similar situations. Accordingly, neither the July 28, 1988 letter to CEC, nor the July 28, 1988 Chief Counsel letter to tax services have the characteristics of a "legal ruling of counsel."

Materials provided by FTB itself indicate that FTB did not issue a "legal ruling of counsel." FTB's Notice 89-277, 410:BRL:CN-89-277, "Re: Taxpayers' Bill of Rights, Franchise Tax Board Chief Counsel Rulings Guidelines," states in part:

"Published rulings consist of our current Legal Rulings, similar in scope and effect to IRS Revenue Rulings; FTB Notices [previously called chief counsel letters or tax service letters], similar in scope and effect to IRS Notices or Revenue Procedures; and informal Announcements or News Releases.

". . .

"B. General Practice and Definitions

". . .

"2. Published Positions, Rulings and Announcements are classified as follows:

"a. Legal Rulings are California's equivalent of Revenue Rulings, and are issued to publish the Franchise Tax Board's official conclusion on

how the law is applied to a specific set of facts. Because they are generally interpretive of existing law, they have retroactive effect unless otherwise stated in the ruling.

- "b. FTB Notices include letters involving substantive interpretation of the law and general procedures to be followed with respect to administrative procedures. They are dated, given a control number, and released to various tax services. Copies are available on written request to the Franchise Tax Board."

[Emphasis added.]

We note that the letter enclosed to CEC carried the name of the Chief Counsel, was dated (July 28, 1988), given a control number (410:BRL:88-357), and released to the tax services. Accordingly, that letter more closely resembles a "FTB Notice" than a "Legal Ruling" under FTB's own guidelines.

Moreover, we find it highly significant that FTB's July 28, 1988 letter to the tax services was not labelled a "legal ruling." This appears to be inconsistent with FTB's previous rulings, which were clearly identified by an assigned "Legal Ruling" number. (E.g., FTB "Legal Ruling 428," labelled as such, and beginning with the words, "The purpose of this ruling" [Emphasis added.] (A copy of this and other FTB "legal rulings" can be found in the California State Law Library -- A55; State Board of Equalization Reports," Matthew Bender & Company, Inc. (1987, 88, 89), Library of Congress Card Number 87-072784.)) If FTB intended its advisory letter to be a legal ruling, then why did it fail to label it as a "Legal Ruling" and assign it a specific ruling number? Nowhere in FTB's Chief Counsel letter to the tax services is the word "ruling" even used.

In our view, it is doubtful that the July 28, 1988 Chief Counsel letter issued by FTB constitutes a "legal ruling of counsel" which is excluded from the definition of "regulation" under Government Code section 11342, subdivision (b). Even assuming arguendo that FTB's letter is such a "legal ruling of counsel," the challenged CEC policy clearly is not. The fact that CEC adopted the conclusions of a "legal ruling of counsel" into its own policy does not automatically exclude the policy from the definition of a "regulation."

46. leaseback, p. 10.

47. Fig Garden Park v. Local-Agency Formation (1984) 162 Cal.App.3d 336, 343, 208 Cal.Rptr. 474, 478.

48. See note 31, supra.
49. Bowland v. Municipal Court (1976) 18 Cal.3d 479, 489.
50. Goins v. Board of Pension Commissioners (1979) 96 Cal.App.3d 1005, 1010, 158 Cal.Rptr. 470.
51. See California Optometric Association v. Lackner (1976) 60 Cal.App.3d 500, 510, 131 Cal.Rptr. 744, 751.
51. According to the California Court of Appeal, Fourth District (San Diego):

"The rulemaking procedure performs important functions. It gives notice to an entire segment of society of those controls or regimentation that is forthcoming. It gives an opportunity for persons affected to be heard. Recently the proposed Rules of the Federal Highway Administration governing the location and design of freeways, 33 Fed.Reg. 15663, were put down for a hearing; and the Governor of every State appeared or sent an emissary. The result was a revision of the Rules before they were promulgated. 34 Fed.Reg. 727.

"That is not an uncommon experience. Agencies discover that they are not always repositories of ultimate wisdom; they learn from the suggestions of outsiders and often benefit from that advice. See H. Friendly, The Federal Administrative Agencies 45 (1962).

"This is a healthy process that helps make a society viable. The multiplication of agencies and their growing power make them more and more remote from the people affected by what they do and make more likely the arbitrary exercise of their powers. Public airing of problems through rule making makes the bureaucracy more responsive to public needs and is an important brake on the growth of absolutism in the regime that now governs all of us.

". . .

"Rule making is no cure-all; but it does force important issues into full public display and in that sense makes for more responsible administrative action."

(NLRB v. Wyman-Gordon Company (1969) 394 U.S. 759, 777-779, 89 S.Ct. 1426, 1436 (Douglas, J., dissenting), quoted in San Diego Nursery Company, Inc. v. ALRB (1979) 100 Cal.App.3d 128, 60 Cal.Rptr. 822, 831.)

Another perspective is furnished by the United States Court of Appeals for the District of Columbia Circuit, a court noted for its expertise in handling administrative law questions:

"The Assistant Secretary should not treat the procedural obligations under the APA as meaningless ritual. Parties affected by the proposed legislative rule are the obvious beneficiaries of proper procedures. Prior notice and an opportunity to comment permit them to voice their objections before the agency takes final action. Congress enacted 5 U.S.C. section 553 in part to "afford adequate safeguards to private interests." H.R. 1203, 79th Cong., 1st Sess. (Comm. Print June, 1945) (quoting S. Doc. 8, 77th Cong., 1st Sess 103 (1941) (Final report of Att'y General's Comm. on Ad. Proc.)), reprinted in S. Doc. 248, 79th Cong., 2d Sess. 20 (1946) (official legislative history of the Administrative Procedure Act). Given the lack of supervision over agency decisionmaking that can result from judicial deference and congressional inattention, see Cutler & Johnson, Regulation and Political Process, 84 Yale L.J. 1395 (1975), this protection, as a practical matter, may constitute an affected party's only defense mechanism.

An agency also must not forget, however, that it too has much to gain from the assistance of outside parties. Congress recognized that an agency's "knowledge is rarely complete, and it must learn the . . . viewpoints of these who the regulation will affect. . . . [Public] participation . . . in the rule-making process is essential in order to permit administrative agencies to inform themselves" H.R. 1203, 79th Cong., 1st Sess. (Comm. Print June, 1945) (quoting S. Doc. 8, 77th Cong., 1st Sess. 103 (1941) (Final report of Att'y General's Comm. on Ad. Proc.)), reprinted in S. Doc. 248, 79th Cong., 2d Sess. 20 (1946). Comments from sources outside of the agency may shed light on specific information, additional policy considerations, weaknesses in the proposed regulation, and alternative means of achieving the same objectives. See National Petroleum Refiners Association v. FTC, 482 F.2d 672, 683 (D.C. Cir. 1973), cert. denied, 415 U.S. 951, 94 S.Ct. 1475, 39 L.Ed.2d 567 (1974). By the same token, public scrutiny and participation before a legislative rule becomes effective can reduce the risk of factual errors, arbitrary actions, and unforeseen detrimental consequences. See Freedman, Summary Action by Administrative Agencies, 40 U.Chi.L.Rev. 1, 27-30 (1972).

Finally, and most important of all, highhanded agency rulemaking is more than just offensive to our basic notions of democratic government; a failure to seek at least the acquiescence of the governed eliminates a vital

ingredient for effective administrative action. See Hahn, Procedural Adequacy in Administrative Decisionmaking: A Unified Formulation (pt. 1), 30 policy direction with the aid of those who will be affected by the shift in course helps dispel suspicions of agency predisposition, unfairness, arrogance, improper influences, and ulterior motivation. Public participation in a legislative rule's formulation decreases the likelihood that opponents will attempt to sabotage the rule's implementation and enforcement. See Bonfield, Public Participation in Federal Rulemaking Relating to Public Property, Loans, Grants, Benefits, or Contracts, 118 U.Pa.L.Rev. 540, 541 (1970). See generally Joint Anti-Fascist Refugee Committee v. McGrath, 341 U.S. 123, 171-72 & n. 19, 71 S.Ct. 624, 648-649, 95 L.Ed. 817 (1951) (Frankfurter, J., concurring)."

(Chamber of Commerce of United States v. OSHA (D.C. Cir. 1980) 636 F.2d 464, 470-471.)

52. Government Code section 11346.
53. Letter from Senior Assistant Attorney General Allen H. Sumner to Assemblyman Young, dated July 19, 1983.
54. Public Resources Code sections 25213 and 25605; former Public Resources Code sections 17052.5, subdivision (f) and 23601, subdivision (d).
55. Select Base Materials v. Board of Equalization (1959) 51 Cal.2d 640, 647.
56. Bowland v. Superior Court (1976) 18 Cal.3d 479, 489, 134 Cal.Rptr. 630.
57. Select Base Materials, 51 Cal.2d 640, 645.
58. People v. Gilbert (1969) 1 Cal.3d 475, 480, 82 Cal.Rptr. 724.
59. The State Board of Equalization (hereinafter, "the Board") was created by former Article 13, section 9 of the California Constitution of 1879. Language establishing the Board is currently found in California Constitution, Article 13, section 17. The Board is charged with administering property and sales tax collection.

Government Code section 15606(b) expressly grants rulemaking power to the Board:

" The State Board of Equalization shall do all of the following:

"(a) Prescribe rules for its own government and for the transaction of its business.

"(c) Prescribe rules and regulations to govern local boards of equalization when equalizing, and assessors when assessing, including uniform procedures for the consideration and adoption of written findings of fact by local boards of equalization as required by section 1611.5 of the Revenue and Taxation Code.

"This section is mandatory." [Emphasis added.]

The final sentence of section 15606 makes clear that the section is mandatory; the Board thus must "prescribe rules and regulations to govern . . . assessors when assessing. . . ."

. . .

The Board's interpretations of property tax statutes appear in several different formats.

- (1) Some interpretations are contained in the California Administrative Code (CAC) (formally adopted pursuant to the APA).
- (2) Some interpretations are contained in "legal rulings of counsel" -- which take the form of letters from a senior board staff attorney to the person who posed the specific question. See, e.g., exhibits B and C to the Board's reply to the Request for Determination (letters signed by assistant chief counsels).
- (3) Some interpretations take the form of "instruction" "Letters to [County] Assessors" signed by a Board division chief.
- (4) Some interpretations take the form of brief summaries of court decisions which have construed the statutes.
- (5) Some interpretations evidently appear in Board-published handbooks.

Of the above list, items 1, 2, 3 and 4 appear in a looseleaf Board-produced publication -- "Property Taxes Law Guide" (emphasis added.). This Law Guide also contains pertinent statutes. Case summaries appear in the Law Guide as annotations to particular statutes. "Legal rulings of counsel" apparently appear in Volume 3 of the Law Guide, which is headed "Property Tax Annotations."

The second "ruling" cited above by the Board (Exhibit C) appears at page 5409 of Volume 3 with the note "C 7/11/80." The Law Guide's explanatory notes indicate that "C" designates an annotation based upon "staff correspondence." The Law Guide does not make clear whether or not all C-coded items are "legal rulings of counsel."

The Board argues at length that County Assessors Letter No. 85/128 is a "legal ruling of counsel." We noted the typical format of the Board's "legal rulings of counsel" in Part I ("Agency and Authority"). Though it lacks all the customary earmarks, County Assessors Letter No. 85/128 is nonetheless a "legal ruling of counsel" -- the Board insists because, though signed by a non-lawyer:

- (1) It was in fact prepared by the Board's Chief Counsel;
- (2) It is a statement of legal principles, including analysis supported by case law and other interpretive materials;
- (3) The analysis deals with the application of specific provisions of law to specifically described types of factual situations;
- (4) It says essentially the same thing said by rulings of counsel dated July 11, 1980 and December 4, 1985.

In its Request, Cal-Tax argues that the challenged Letter is not a legal ruling of counsel because it was signed by the Assessment Standards Division Chief, and is not a ruling related to a specific factual situation involving specific parties.

We agree with Cal-Tax. County Assessors Letter No. 85/128 is not a "legal ruling of counsel." We reach this conclusion for the following reasons:

- (1) Based on the examples submitted by the Board, a "legal ruling of counsel" has the following characteristics:
 - (a) It is signed by a Board attorney;
 - (b) It is initially directed to a specific person and answers a specific question concerning tax liability in a particular factual context;
 - (c) It is summarized in the annotation volume of the Property Tax Law Guide and is labelled "C" for "staff correspondence."
 - (d) Copies with the original addressee's name and other identifying data deleted are made available upon request to other interested persons.
- (2) Under the Board's definition of the statutory term, the exception swallows the rule. Despite other statutory

requirements to the contrary, the Board would be free to dress up any tax-related "policy" as a "legal ruling of counsel" and thus evade APA notice and public comment requirements. Mindful of the Armistead court's comment about persistent agency efforts to evade APA requirements, we are determined to carry out the intent of the Legislature as expressed in all pertinent statutes and will not permit an overbroad interpretation of one particular phrase to defeat legislative purposes.

Government Code section 11347.5 forbids use of regulatory informal rules. Government Code section 15606 mandates the Board to prescribe "rules and regulations to govern . . . assessors when assessing." Government Code section 11342(b) provides that "regulation" does not include "legal rulings of counsel." Read together, these statutes make clear that the Board must in general formally adopt regulations which govern assessors when assessing, but is free to continue its customary practice of informally advising tax attorneys, etc., of the tax consequences of particular proposed transactions. If, in the preparation of a particular tax counsel ruling, the Board realizes its "legal ruling of counsel" to the person posing the question--but should nonetheless begin a rulemaking action by preparing a notice of proposed rulemaking. If the new rule is formally adopted pursuant to the APA, the regulated public will have an opportunity to comment upon and shape the rule before it takes effect and, also, a record will be compiled which will facilitate judicial review of the enactment.

60. We wish to acknowledge the substantial contribution of Unit Legal Assistant Melvin Fong and Senior Legal Typist Tande' Montez in the processing of this Request and in the preparation of this Determination.